EDITORIAL

While the SEC has been finalizing the outstanding Security-Based Swap Dealer rules, we wanted to devote the larger portion of this newsletter to the recent developments in that space. Although the registration compliance date for Security-Based Swap Dealer registration is still not set, the SEC has privately communicated that the final rules (clearing, margin and segregation) that trigger the registration compliance date, will be completed “early 2017.” Publicly, Mary Jo White, the Head of the SEC, stated in a speech at the SIFMA Annual Meeting in DC this week that the SEC is working hard to finalize all the rules before the end of the year. Given both statements the compliance date seems to be targeted for end of June/beginning of July taking into account a 1 month period to publish the final rules into the Federal Register. Despite knowing the exact timing, market participants who exceed the de minimis threshold for Security-based Swaps have started to invest significant resources into establishing their compliance framework. The current focus for the banks regarding Security-Based Swap Dealer rules is to ensure that an impact analysis is performed for all activities and to set up the project organization structure required to effectively analyze regulatory requirements and efficiently implement compliance programs. To that end, banks will most likely leverage their CFTC project organization programs which were used to implement the CFTC Swap Dealer rules.

With various regulatory updates currently at the center of attention for the Banking Industry, we also wanted to provide a brief summary of other regulatory topics. These regulatory topics have been supplemented by an assortment of blog articles that explore other important regulatory matters.

Lastly, we are pleased to announce that Sia Partners continues to expand the scope and breadth of its Risk & Regulatory practice with an increase in the number of assignments on various topics such as Volcker, Dodd-Frank Title VII and Liquidity Stress Testing requirements.

We hope you will enjoy this newsletter. Please let us know if you have any comments, questions or suggestions!

Aurelien Borde & Conner McMahon
Security-Based Swap Dealers: Final Preparation

Context

Title VII of the Dodd-Frank Act ("DFA") established a new regulatory framework for OTC derivatives, intended to reduce risk, increase transparency, and promote market integrity. Under Title VII, the Securities and Exchange Commission ("SEC") has regulatory authority over Security-Based Swaps ("SBS"); jointly with the Commodity Futures Trading Commission ("CFTC"), the SEC has authority over all "mixed swaps," and is the sole agency with antifraud authority over both swaps and SBS.

Security-based Swaps cover those swaps whose underlying asset is a single-name security, loan, narrow-based group or index of securities, or events relating to a single issuer or issuers of securities in a narrow-based index. Entities conducting significant transactions in SBS are required to register as a Security-based Swap Dealer ("SBSD") or a Major Security-based Swap Participant ("MSBSP").

As banks await the final word on when the "clock starts ticking" for security-based swap dealers, we would like to walk through the recent developments and final rules released and what banking entities can be doing now to prepare for the upcoming Compliance Date release.

Final Registration Requirements

On October 13, 2015, the SEC adopted new Rules establishing the process by which SBS Entities must register with the SEC. Although the Rules were published in the Federal Register on August 14, 2015, and became effective that October, the actual Compliance Date has not yet been announced. The Compliance Date will be effective based on the later of the following dates:

- 6 months after publication of the final rule establishing capital, margin, and segregation requirements for SBS entities
- The compliance date for the final rule establishing recordkeeping and reporting requirements for SBS entities
- The compliance date for the final rule establishing business conduct standards requirements for SBS entities
- The compliance date related to requirements for SBSD Associated Persons that are subject to statutory disqualification
Two months prior to the Compliance Date will be the **Counting Date**, at which point SBS entities will be required to begin calculating whether their activities exceed the thresholds to become SBSDs or MSBSPs. It was decided that only SBS positions held on or after this date will be included in determining if a SBS entity must register.

To ensure that existing entities will not be required to cease operations pending the Commission’s consideration on their application, the Final Rule allows for a “conditional registration” that gives SBSDs and MSBSPs the opportunity to come into compliance with the new rules gradually. Following the conditional registration, the SEC will either grant the applicant permanent registration or require the applicant to correct deficiencies and resubmit.

**Cross Border Security-Based Swap Activity**

On February 10, 2016, the SEC finalized the Cross-Border Security-Based Swap Activity Rule. The Final Rule requires that a non-U.S. person that uses U.S. personnel to arrange, negotiate or execute an SBS transaction in connection with the non-U.S. person’s SBS dealing activity must include such transactions in determining whether the non-U.S. person would be required to register as an SBSD with the SEC. Put more simply, if a person outside of the U.S. uses someone in the U.S. to complete a swap transaction, this swap must be included in the de minimis calculation.

The de minimis exception is important to potential swap entities because the SEC has ruled that a person will not have to register if its activity and the activity of its affiliates remain below certain thresholds as defined below:

**Phase-In Period**

- Credit Default Swaps - $8 billion gross notional
- Other SBS transactions - $400 million gross notional
- Transactions with Special Entities - $25 million gross notional

**Final Thresholds**

- Credit Default Swaps - $3 billion threshold
- Other SBS transactions - $150 million threshold

During the Phase-In Period, the SEC will study the SBS market to determine necessary modifications to the regulatory framework. Following this three to five year evaluation period, the SEC will then implement the Final Thresholds above. For U.S. dealers, only those transactions entered into in a dealing capacity will count during the threshold and not commercial hedging nor transactions with majority-owned affiliates. For non-U.S. dealers, they must calculate de minimis based on their counterparty – if the counterparty is a U.S. person or, as said above, a non-U.S. person that arranges the transaction under its agent in a U.S. branch or office.

**Business Conduct Standards**

On April 14, 2016, the SEC issued the final rules implementing a set of business conduct standards and Chief Compliance Officer requirements for SBSDs and MSBSPs. According to the SEC, “The Rules are designed to enhance transparency, facilitate informed customer decision-making, and heighten standards of professional conduct to better protect investors.”
The SEC stated that it worked closely with the Commodities Futures Trading Commission (CFTC), the regulatory body for swap dealers (SD) and major swap participants (MSP), throughout all stages of the Business Conduct Standards rulemaking process. The CFTC issued external business conduct standards in 2012 for SDs and MSPs, and most entities have worked diligently to be compliant. It is worth noting that the SEC rules have subtle differences in wording from the CFTC rules, but each regulator attempted to portray similar principles (ex: as opposed to the CFTC, SEC will not grant substituted compliance for business conduct standards).

The SEC has designated specific requirements as applicable to all security-based entities (SBSD & MSBSP) and others as applicable only to SBSDs.

**Both** security-based swap dealers and major swap participants are required to:

- Verify whether a counterparty is an eligible contract participant and whether it is a special entity
- Disclose to the counterparty material information about the security-based swap, including material risks, characteristics, incentives and conflicts of interest
- Provide the counterparty with information concerning the daily mark of the security-based swap, as well as concerning the ability to require clearing of the security-based swap
- Communicate with counterparties in a fair and balanced manner based on principles of fair dealing and good faith
- Establish a supervisory and compliance infrastructure
- Designate a chief compliance officer who is required to fulfill the described duties and prepare an annual compliance report

**Only** security-based swap dealers are required to:

- Determine that any recommendations they make regarding security-based swaps are suitable for their counterparties
- Establish, maintain and enforce policies and procedures reasonably designed to obtain and retain a record of the essential facts concerning each known counterpart that are necessary to conduct business with such counterparty

The effective date of these rules will be 60 days following their publication in the Federal Register. However, much like the SBS Entity Registration Compliance Date, the exact compliance date for the Business Conduct Standards is unknown at this point.

**Trade Acknowledgment and Verification Rules**

The Trade Acknowledgment and Verification Rules for security-based swap transactions were recently finalized by the SEC. As SEC Chair Mary Jo White expressed, "These rules will result in more accurate and timely documentation for security-based swap transactions, which is a cornerstone of effective risk management.”

Announced on June 8, 2016, the final rule will require SBS entities to provide a trade acknowledgment that contains all of the terms of the transaction. Basically, the entity will have to acknowledge the terms of the trade and verify or dispute those terms. Additionally, the rule will require entities to have a robust policy and procedure framework around trade acknowledgments and to provide an electronic trade acknowledgment to its transaction counterparty no later than the end of the first business day following the day of execution.
Additional Security-Based Swap Transaction Reporting Rules

Lastly, on July 13, 2016 the SEC announced that it would adopt new Final Rules governing security-based swap data reporting (SBSR) and public dissemination. Final Regulation SBSR addresses many issues left open by the Commission’s initial proposal in 2015, such as the application of the regulation to SBS activity of non-US persons within the United States. Listed below are key points of the regulation:

- National securities exchanges or SEFs must report SBS executed on the platform that will be submitted to clearing
- A registered clearing agency must report any SBS to which it is a direct counterparty and whether or not it accepts a transaction for clearing
- Registered SDRs may not impose fees or restrictions on the SBS transaction data required for public dissemination
- Any SBS transaction connected with a non-US person’s SBS dealing activity that is arranged by its personnel or an agent in a US branch or office must be reported and publicly disseminated
- A new compliance schedule for portions of Regulation SBSR that have not yet been assigned compliance dates

Compliance for these portions of Regulation SBSR will be phased in over a period of months, beginning on the first Monday that is the later of: six months after the date on which the first SDR that can accept transaction reports in an asset class registers with the Commission; or one month after security-based swap dealers and major security-based swap participants are required to register with the Commission.

What can a potential security-based swap dealer do now?

The answer is quite simple: prepare! Similarly to the CFTC Swap Dealer implementation, security-based swap dealers should continue to use this time to review and understand the many facets of the Final Rules previously discussed and develop the various work streams necessary to implement an adequate regulatory framework.

As stated previously, U.S. and non-U.S. dealers must assess their activity and whether it breaches the various phase-in thresholds identified by the SEC rules. This process will help the potential dealer in determining whether registration is required and how to begin the process of developing a proper regulatory environment.

If the banking entity of the security-based swap dealer previously implemented a framework for a swap dealer under the CFTC, the process of creating work streams will likely be similar. The process of implementation, however arduous it may be, will require buy-in from many stakeholders, from Client Services to the Front Office. If a banking entity does not have an existing swap dealer, they should determine where the regulatory undertaking of a new security-based swap dealer would fit most efficiently within its business as a whole.

Furthermore, for those firms not registered as a swap dealer or broker dealer, the paperwork and documentation needed to complete the registration will be extensive and advanced preparation could be helpful when the Compliance Date finally arrives. For those not currently registered will complete Form SBSE, those registered as a broker dealer (with the SEC) will complete Form
SBSE-BD, and those registered as a swap dealer (with the CFTC) will complete Form SBSE-A. The banking entity can also begin the development of the policy and procedure and control frameworks. Many of the existing policy and procedures, if any, will need to be supplemented with new documentation.

As banking entities await the finalization of the outstanding rules, the coming months will prove be an important time for security-based swap dealers before the "clock starts ticking".

Sources:


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Regulatory News

SIFMA C&L Society New York Regional Seminar 2016
Sia Partners will attend the Compliance and Legal Society Regional Seminar as a sponsor on November 2nd at the Marriott Marquis in New York. Roundtables will address the following topics: Current Issues in Wealth Management, Recent Regulatory Issues, Ethics, Hot Topics in Compliance, AML & Anti-Corruption and Securities Industry Enforcement Trends.

http://www.sifma.org/cl-newyork2016/

Margin Requirements for Uncleared Swaps
The rules on initial and variation margins came into effect on September 1st. The US prudential regulators did not provide any time-limited no action relief, however the CFTC issued a 30-day no action relief for enforcement against their margin rules. Under the rules, Swap Dealers are required to post or collect collateral (initial margin and variation margin) when they enter into a swap transaction that is not centrally cleared through a Derivatives Clearing Organization. The September 1st compliance date applies to the largest Swap Dealers, whose compliance threshold exceeds 9 billions as defined in the rules.

SEC Update
Regulation SBSR-Reporting and Dissemination of Security-Based Swap Information – The Securities and Exchange Commission adopted certain amendments to Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information ("Regulation SBSR"). Specifically, new Rule 901(a)(1) of Regulation SBSR requires a platform (i.e., a national securities exchange or security-based swap execution facility that is registered with the Commission or exempt from registration) to report a security-based swap executed on such platform that will be submitted to clearing.
SIFMA/IIB Advocacy Efforts for non-resident Security-based Swap Dealers
On August 26, 2016 SIFMA and the IIB presented a request for clarification to the SEC regarding two requirements that conflict with existing laws in several jurisdictions outside the US. The request for clarification concerns the following Rules; (1) Certification and Opinion Requirements for Non-Resident SBSDs and (2) Associated Person Certification and Background Checks. Given the short deadline for registration these efforts, as well as other advocacy efforts will go a long way in determine how the SBSDs for the impacted banks are structured and where they may conduct their business. There has not been any formal communication on when the SEC will respond to SIFMA and IIB’s letter.

CFTC Update
The CFTC Approved the Final Rule to Amend Swap Data Recordkeeping and Reporting Requirements for Cleared Swaps - On June 14th, 2016, the U.S. Commodity Futures Trading Commission (CFTC) approved a Final Rule that amended existing swaps reporting regulations in order to provide additional clarity to swap counterparties and registered entities regarding their reporting obligations for cleared swap transactions; and to improve the efficiency of data collection and maintenance associated with the reporting of the swaps involved in a cleared swap transaction.

http://www.cftc.gov/PressRoom/PressReleases/pr7389-16

CFTC Expands Interest Rate Swap Clearing Requirement
On September 28, 2016 the CFTC expanded the existing clearing requirement for interest rate swaps. The Commission voted unanimously to approve an amendment to Commission regulation 50.4(a) that establishes a new clearing requirement determination. Compliance with the expanded interest rate swap clearing requirement will be phased-in according to an implementation schedule based on when analogous clearing requirements have taken, or will take, effect in non-U.S. jurisdictions. There is a two-year time limit on this phasing schedule to provide certainty to market participants.

http://www.cftc.gov/PressRoom/PressReleases/pr7457-16

July 1st 2016 Compliance Deadline for Large Foreign Banking Organizations
On July 1st, 2016, large Foreign Banking Organizations subject to the Enhanced Prudential Standards were required to form their US Intermediate Holding Companies (IHC) and to comply with the risk-based capital requirements defined under the U.S. Basel III final rules. Large Foreign Banks are now developing their IHC Day 2 action plan to solidify their processes.
FASB issues long awaited changes to credit loss model: CECL to replace current standard
On June 16, 2016, the FASB completed a new credit loss standard that altered the impairment model for measuring credit losses. Known as the current expected credit loss model, the new model was issued in ASU No. 2016-13, Financial Instruments—Credit Losses. According to the American Bankers Association, Bank regulators have described CECL as the “biggest change to bank accounting ever.” - To read more...

The Brexit: Potential US Regulatory Impacts
On June 23, 2016, the U.K.’s electorate narrowly voted to leave the European Union in a historical first. The Brexit, as it has been dubbed, immediately sent shockwaves through international markets wiping out nearly 2 Trillion USD from the FTSE and other leading indices. Though it is far too early to fully understand the full scope of the Brexit’s impact, there may be immediate and significant impacts to U.S. Bank Holdings Companies operating in London, further impacting U.S. regulatory reporting and compliance. Below, Sia Partners briefly speculates on potential Brexit impacts on U.S. regulatory compliance and reporting. - To read more...

The New York Department of Financial Services’ Emerging AML Requirements
In recent years, Anti Money Laundering (AML) has become both a hot topic for regulatory scrutiny and pain point for many financial institutions operating in New York State and beyond. There have been multiple high profile fines, threats by regulatory bodies of criminal sanction against violators, and ever-increasing compliance requirements and burdens. Amid this climate, state regulators in conjunction with federal guidelines have sought to create tough new regulations concerning AML requirements. Specifically, on June 30, 2016, the New York State Department of Financial Services (NY-DFS) published its “Final Regulation”, imposing new Transaction Monitoring and Filtering Requirements for detection and identification of potential violations of Anti-Money Laundering Laws and Sanction Programs administered by the Treasury Department’s Office of Foreign Asset Control (OFAC). - To read more...

The Panama Papers: Implications for Banks
After the Panama Papers were released to the public in April 2016, over 100 media organizations in over 80 countries published articles illustrating the Panamanian law firm Mossack Fonseca’s role in laundering money for many of the world’s most powerful and influential people. Over 11.5 million documents were leaked implicating world leaders, politicians, business leaders, sanctioned entities and celebrities. Mossack Fonseca specialized in concealing beneficial ownership and laundering money to avoid the payment of taxes. Due to the quantity and type of clients of Mossack Fonseca, United States and international regulators are considering what to do next. What is for sure is that the Panama Paper’s implications will be extensive. - To read more...

(With)held up on how to comply with Section 871(m)
The IRS recently took action to close an unintentional loophole in the Internal Revenue Code (IRC). The Final Regulations of Section 871(m) mandate a withholding tax of up to 30% on certain notional principal contracts, derivatives, and other equity linked payments that reference dividend payments on underlying US-sourced equity securities (also known as dividend equivalents), provided that the transaction satisfies certain requirements.

The impact of 871(m) is global and significant. Not only will the Final Regulation create a need for significant operational transformations in both US and non-US based financial institutions, they will also affect the way certain businesses within banks currently operate. - To read more...
Volcker and French Banking Law Compliance Program Design and Implementation at a Non-US Banking Entity
We are assisting the Volcker Office of a Non-US Banking Entity with the deployment of their Enhanced Compliance Program for Volcker and French Banking Law across all business lines and geographies. The scope of the assignment includes the contribution to the deployment and execution of the Compliance Program (Internal Control Plan, Training, Target Operating Model of the Independent Testing, CEO Attestation and sub-certification, etc.), the writing of Policies and Procedures at the Group Level and P&P templates to support the deployment of the Program at Business Line level and within the various Functions (Compliance, Risk, etc.), and the PMO support (governance meetings, follow-up the progress of the execution effort across Business Lines and Functions and reporting to Senior Management).

Margin Requirements for Uncleared Swaps at a Regional US Bank
We recently completed an assignment that aimed at designing and coordinating the implementation of a compliance and operational framework to meet the new margin requirements for uncleared swap requirements by September 1, 2016, including initial margin calculation, enhancements to the collateral management framework, re-papering of the agreements, and documenting the policies and procedures.

Liquidity Stress Testing Models Review at a Global French Bank
We have been selected by a Global French Bank to perform a review of their liquidity stress testing models from a data quality and model implementation standpoint. The goal of the assignment is to identify gaps against expectations outlined in the Supervisory Guidance SR 11-07 and industry practices, and to provide recommendations and a roadmap of executable actions to address the identified gaps.

CFTC Swap Dealer Assessment at a Non-US Swap Dealer
We are currently performing an assessment of a Non-US Swap Dealer and its compliance with all relevant CFTC requirements. This is the third Swap Dealer assessment that we have conducted over the last 12 months and we have now acquired a leading position among consulting firms in this space. Our approach is based on our Swap Dealer Assessment Matrix and a proven methodology combining walkthroughs, documentation reviews and comprehensive testing on specific topical areas. It will result in a report detailing compliance gaps and remediation recommendations.

Enhancements to the Risk Reporting Solution for an Asset Manager
We have been engaged to conduct a project to enhance the Key Risk Indicators (KRI) Reporting Solution of an Asset Manager, by improving the current state and the end-user experience, and automating processes and data integrity checks.

CCAR Solution Implementation at a Large Foreign Banking Organization
We are assisting a Large Foreign Banking Organization with their CCAR solution implementation project. The solution aims at automating the end to end production process of the FR-Y 14A reports, along with the necessary related control framework.

### About Sia Partners

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Founded in 1999, Sia Partners is an independent global management consulting firm with over 850 consultants and an annual turnover of USD 155 million. The Group has 20 offices in 15 countries, including the U.S., its second biggest market. Sia Partners is renowned for its sharp expertise in the Energy, Banking, Insurance, Telecoms and Transportation sectors.